PENDENCY PLAN
City of San Bernardino

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SUMMARY

This report proposes to take a number of actions related to the City's budget that combined represent the City's financial plan for Fiscal Years 2012-13 and 2013-14 and, if approved by the Common Council, will serve as the City's Pendency Plan. The City's Pre-Pendency Plan submitted to the Mayor and Common Council by the City Manager on August 29, 2012, September 5,2012_ and October 1, 2012 included a plan for all of the City's funds for Fiscal 2012-13. It was noted that the General Fund remained out of balance while the City worked through labor negotiations and discussions with its creditors in an attempt to restructure financial obligations that would balance the fund. While the negotiations process continues, the City must present a balanced financial plan, or Pendency Plan, for the General Fund that allows the City to continue to provide effective service. This Pendency Plan would serve as the City's budget while it is under Chapter 9 protection and is presented for Council consideration as part of this staff report.

The Pendency Plan provides a balanced General Fund through cost reductions to labor, benefits, debt and other obligations, the details of which are provided below and in the supporting financial schedules. It should be noted that solvent funds may experience some beneficial impact of the Pendency Plan changes due to organization wide changes to labor agreements. After the Pendency Plan is approved, staff will return to the Mayor and Common Council and present the balance of the non-General Fund operating and capital budgets for approval.

DISCUSSION

The City of San Bernardino has reached a cross roads. Years of financial struggles and challenges from declining revenues and increasing fixed costs have placed in the City in the position of making difficult service delivery decisions and financial restructuring a necessity. Continued financial imbalance between revenues and expenses have now exhausted the City's general financial reserves and burdened it with obligations it cannot pay, obligations that exceed its current year General Fund resources by $45.8 million in Fiscal Year 2012-2013 and that, unless addressed structurally to be sustainable, will continue to grow in future years.

Like most cities in the State, the City of San Bernardino enjoyed the building boom in the past decade and the aggressive asset valuation and increasing sales tax growth that followed. Unfortunately, when the boom ended, San Bernardino found itself terribly exposed to the combined impacts of the Great Recession, the collapse of the housing market and the credit/ b anking crisis of 2008-2009. Revenues plummeted combined with generous pay and benefit packages, became unsupportable. This situation is further exacerbated by a high foreclosure rate and one of the highest unemployment rates in the country.

This Council has had to deal with plummeting revenues and steadily increasing fixed costs that increased the City's vulnerability to the economic storm. Despite efforts to reduce expenditures and put the City's financial house in order, the City is insolvent. During the past two years it became clear the City's financial position was weakening and its employment contracts, post-employment benefits and unfunded liabilities incurred over the last 15 years cannot be supported if the City is to continue delivering services crucial to protecting the health, safety and welfare of the community. The overall poverty level in the City has steadily increased over the past 15 years and the City has few resources to support its most vulnerable citizens. At the same time, drug and gang activity have left the City growing concern for increasing levels of violent crime.

As described in extensive reports to the Mayor and Common Council in recent months, the City is insolvent. Now, only the difficult process of restructuring its long-term financial obligations and fixed costs will enable the Mayor and Common Council to protect the community and make sure that the City emerges from this financial crisis as a viable, sustainable institution. The Mayor and Common Council began that work on June 26, 2012, when it authorized the City Manager to develop a financial and organizational restructuring plan necessary to balance revenues against expenses.

The City is working with its employee unions and associations, and its creditors, to reach agreements that would restructure the City's unsustainable financial obligations. Negotiations continue as this report is being drafted.

At this time, however, the City cannot assume that agreements reached will enable the Mayor and Common Council to completely close the budget gap. The City must be prepared to balance its budget through a Pendency Plan implemented in the Chapter 9 case.. The alternative to a Pendency Plan that imposes selective reductions in the City's financial obligations are deep service reductions that are simply unacceptable because they are dangerous to our citizens or they threaten the future economic viability of the City. Should any tentative agreements be reached by the parties, they will be honored and will contribute to the City's ability to use bankruptcy as efficiently and expeditiously as possible. If agreements are reached and ratified with some or all of creditors after adoption of this agenda item and its contents, those new Memoranda of Understanding or agreements would modify the actions in the Pendency Plan.

Without the changes incorporated into the budget as part of its Pendency Plan for the General Fund, the City cannot adopt the balanced budget required by its Charter and the State Constitution. This would affect its ability to pay its employees and suppliers and further interrupting critical service delivery during the fiscal year. In fact, by approving this Pendency Plan, the Mayor and Common Council will be protecting critical services and the San Bernardino citizenry.

The City's Capital Improvement Program (CIP) is a five year plan that addresses facility and infrastructure needs for the City and is currently being updated and finalized for review once the Pendency Plan measures are known. The bulk of the funding for Capital Improvements come from restricted sources such as Measure I, a half-cent voter approved sales tax for street improvements, State Gas Tax or from the City's utility funds restricted for improvements to the utility systems.

Although the CIP will not receive funding from the General Fund in Fiscal 2012-13 nor under the Pendency Plan. This level is far below the amount needed to address existing deficiencies or ongoing needs for maintenance of capital assets essential to functions funded through the General Fund.

An amendment to the California Constitution intended to limit growth in local government spending requires establishment of a maximum limit for expenditures from general taxes. The limit is indexed to specified growth factors approved by the Legislature. The City's annual appropriation limit will be calculated once the Pendency Plan measures are known for 2012-13 pursuant to the requirements of the California Government Code. This limit pertains to appropriations from general taxes and is far above the general taxes the City has available to appropriate. The City of San Bernardino uses the "change in California per capita personal income" for the "change in cost of living" component of the calculation of the appropriation limit. The growth of the index and recent declines in tax revenues leave the appropriation limit much higher than the general taxes available for expenditure.

PENDENCY PLAN

The Preliminary FY 2012-13 Operating Budget included a General Fund deficit of $45.8 million and indicated that a contingency, or balancing, plan to close the gap would be forthcoming. That plan is known as the Pendency Plan.

The Pre-Pendency Plan presented on August 29, 2012, and the amendments to the Pre-Pendency Plan referenced in this Report, together, represent the City's Fiscal Years 2012-13 and 2013-14 Budget and will serve as its Pendency Plan during the bankruptcy proceedings and will allow the City to balance its budget. The Pendency Plan represents the spending levels the City needs to implement to become and remain solvent. Those spending levels are lower than the levels that would be required to deliver adequate services and meet all the requirements of the City's contractual obligations. Spending levels adequate to pay contractual obligations would exceed revenues and there are no reserves to make up the difference. The California State Constitution and the City Charter prohibit the City from adopting a budget that is out of balance, preventing the City approving expenditures unless the budget is balanced. Without restructuring its finances or maintaining the protection of Chapter 9, the City could not pay its employees, retirees, bondholders or vendors. This would result in uncontrolled default and, presumably, a collapse of public services.

Bankruptcy protection assures that this will not happen in San Bernardino, though we cannot say how much creditors will, or will not, receive. The term "Pendency Plan" was developed in the City of Vallejo Chapter 9 case to describe the plan the City would operate under pending the completion of the bankruptcy process. Amendments to the plan or extension of the plan into future fiscal years could occur. Because the Great Recession struck Vallejo after it filed for bankruptcy protection it had to make many changes in its plan to adjust to worsening economic conditions.

During the period the City operates under the Pendency Plan in bankruptcy, the differences between payments required by contracts and the amount actually paid become claims in bankruptcy and are resolved through negotiations and, ultimately, the Plan of Adjustment submitted to the creditors for approval and to the bankruptcy court for confirmation. In Vallejo, after three years, all classes of creditors voted to accept the Plan of Adjustment; however, under the Bankruptcy Code, the court can confirm a Plan of Adjustment even if some classes of creditors disapprove; a process known as "cram down".

The Vallejo Chapter 9 case took many months because suits determining General Fund access to restricted fund resources and issues regarding bankruptcy court jurisdiction and California labor laws had to be decided. We hope decisions in this case will provide the appropriate guidance in our case and reduce the litigations costs while in bankruptcy.

Amendments to the Pre-Pendency Plan

This Report describes further changes to the Pre-Pendency Plan required for solvency in Fiscal Years 2012-13 and 2013-14 under the protection of Chapter 9. The changes are based on adjustments intended to implement important principles that have guided the preparation of the Proposed Budget, especially in the General Fund. In addition minor technical corrections in estimates and calculations have been included based on actuals for the first quarter of the fiscal year. The changes described below will be important to the City's creditors. A description is included below of these principles and how they play out in the budget balancing plan.

Promote Health, Safety and Welfare – Protecting the health, safety and welfare of the community continues to be the top priority for the financial restructuring process. Service levels are inadequate throughout the City, though public safety has received special attention as the City balances competing demands for resources. Given the extremely high crime rates in San Bernardino, the foundation of the City's future must be safety, and the City's actions to assure that grant funded public safety positions continue to receive funding as grant funds expire reflect the commitment to that. Due to turnover, the base budget also includes funding to assure that the Police Department has resources to recruit and train new officers to fill vacancies, to take advantage of new staffing grants, and to assure that services are available for the community. This principle shaped the decision to recommend no additional significant service reductions.

Minimize Impact on Future Services - The future also depends on stewardship of public assets in the form of maintenance, repair and replacement. Unfortunately, funding limitations do not allow even the modest expansion of these investments in the Pendency Plan despite ongoing deterioration of assets. In fact, some minor reductions in Public Works contract work and transfer of right of way median maintenance to Gas Tax funding is included. Other services that will assure the City can rebuild its reputation as a great place to live and invest continue with only very minor cost reductions planned for recreation, parks and libraries. The City's sewer and integrated waste utilities and other solvent funds are structured to operate with only indirect impacts from the insolvency of the General Fund and the Pendency Plan. Solvent funds, like utility enterprises will actually benefit from some of the organization wide reductions made as part of the Pendency Plan.

Maintain Competitive Compensation Packages – It is essential the City maintain competitive pay and benefit programs to retain and attract qualified, motivated employees. In the past, the City's pay and benefit packages were among the most generous in its market area, sometimes significantly above the regional market. The City has, through negotiation or through imposition of reductions covered by its fiscal emergency powers, reduced compensation and benefit packages for its employees. These include employee payment of their PERS contributions, capping contributions to employee health plans and reducing costs by changing carriers, limiting pay outs, seeking new, lower pension benefit levels for new hires and eliminating retiree health insurance for new hires. The additional, but selective, changes here continue to address situations where compensation is above market and has created excessive liabilities that cannot be paid without unacceptable reductions in service. The primary reductions proposed herein relate to retirement costs and benefit structure.

Balance Costs and Service Impacts of Reductions – Cost reductions in the Pendency Plan have been designed to minimize service impacts. As noted above, reductions in employment benefits will not affect service levels. In comparison, significantly reducing salaries could have immediate direct impacts on current employees and would make recruiting and retaining qualified staff nearly impossible.

Build Fiscal Sustainability – The Mayor and Common Council's often-stated goal for the restructuring process has focused on sustainability, which means building adequate reserves, covering the full cost of operations, implementing proper stewardship of public assets and building competitive, affordable compensation packages over the long run. Inadequate financial resources result in compromises in the Pendency Plan. Elements of the Proposed Budget aimed at stabilization and sustainability like maintenance investments are deferred in the Pendency Plan. Other sustainability measures like restoration of adequate, pay-as-you-go funding of internal service costs and the basic commitment to competitive compensation remain. The Pendency Plan must appropriate funding for restructuring expenses because sustainability is central to the City's effort to return to fiscal health.

General Fund Spending Changes Implemented in this Pendency Plan

The principles built into the Pendency Plan come in different forms. They include suspension of debt payments and payments for legal claims, continued reductions on pay and benefits imposed under emergency powers, reductions to over market compensation components, transfers of eligible costs to other funds, necessary legal and financial consulting services to pursue the City's interests via bankruptcy and, possibly, via labor negotiations and limited revenue increases. These changes eliminate the $45 million FY 2012-13 General Fund gap identified in the preliminary budget and begin to address the City's General Fund cash deficit of $18 million. The City's current deficiency and efforts taken to date are addressed in greater detail on page 8 of this Report.

The further reductions proposed in the Pendency Plan are detailed on pages 9 and 10 of this Report. Impacts are ongoing in nature unless otherwise noted and are reflected in the attached schedules.

Summary of Pendency Plan Reductions and Deferrals

Salary, Wages, and Benefits Balancing Measures ($26,064,125)

1. Complete implementation of the Pre-Pendency Plan approved by the Mayor and Common Council.
2. Eliminate vacant sworn positions in the Police Department.
3. Achieve employee concessions that reflect full implementation of the State's pension reform.
4. Eliminate the Constant Manning provision in the Fire Department which results in a 35% reduction in overtime.
5. Phase out the Other Post Employment Benefit (OPEB) implied subsidy for retiree health.
6. Reduce the OPEB direct payment for health care for police retirees to the amount afforded to other employees.

7. Eliminate the 9% Employer Paid Member Contribution (EPMC) for police and fire.

Deferral of General Fund Obligations ($34,959,311)

1. Defer reimbursement of the Restricted and Non-Restricted Funds. Reimbursement would be addressed in future years.
2. Defer the CalPERS payments less the Employee Withholding and negotiate repayment over time.
3. Suspend Paid Time Off payments to all employees.
4. Defer debt service on 2005 Pension Obligation Bonds.
5. Discuss the reamortization of the CalPERS liability with CalPERS actuarials.

Revenue Related Balancing Measures

While new revenues are not projected in FY 2012-13 due to the timing of implementation, it is recommended the Council consider and provide direction related to new revenue measures to be explored further. The Pendency Plan identifies four measures for Council consideration or the Council may identify other measures.

Indirect Impacts on Other Funds

The Pendency Plan focuses on the insolvent General Fund but has implications for other funds. All reductions apply to employees equally regardless of their fund assignment or allocation, and all funds will have cost reductions associated with personnel cost changes. Potential changes in required subsidy levels from the General Fund resulting from those savings have not been programmed at this time.

The primary impact of these Pendency Plan changes on other funds is a reduction in salary, wages, and benefit costs. These changes will be offset by allocations of costs related to the Chapter 9 process and continuing efforts to work with investors, rating agencies and insurers of bonds to emphasize and clearly disclose the strength of the revenue and cash balances that support repayment of these bonds.

STATE OF FISCAL EMERGENCY

The Mayor and Common Council, by Resolution 2012-205, declared a state of fiscal emergency based on fiscal circumstances on July 16, 2012. It is recommended the Council authorize the continuation of the Fiscal Emergency through June 30, 2014. With respect to MOUs that have expired and to the extent that the meet and confer process under the Meyers Milias Brown Act is not yet complete, the Council hereby finds that the need to immediately implement the Pendency Plan constitutes an emergency within the meaning of Government Code section 3504.5, authorizing the immediate implementation of such plans while the City completes any remaining aspects of the meet and confer process. This emergency is based upon the findings in this Report, and in the staff report and accompanying Resolution adopted by the Mayor and Common Council.

CONCLUSION

Despite the drastic reductions in staffing and service levels, the City of San Bernardino is insolvent from both a financial and service delivery perspective. Further reductions to service levels would jeopardize the health, safety and welfare of residents, and would severely limit the City's chances for economic development. The City has a responsibility to provide the services the citizens deserve and require, and the limited resources available to the City need to be focused on preserving basic services and providing for public health and safety given the high crime rates, poverty levels and other socio-economic challenges facing the community. It is with hope for a financially stable and fiscally responsible future, that the proposed Pendency Plan is submitted. We are committed to continuing to participate in good faith negotiations with our creditors going forward in the bankruptcy process and remain committed to getting San Bernardino to a position of fiscal solvency such that it can remain able to deliver essential services.

CITY OF SAN BERNARDINO, CALIFORNIA
PENDENCY PLAN
FY 2012-13 and FY 2013-14

CURRENT FINANCIAL SITUATION

General Fund Cash Projection	FY 2013 Base Year
Receipts	$ 120,424
Disbursements	(166,237)
Deficiency Before Transfers	**(45,812)**
Transfers	4,830
Total Operating Deficiency	**(40,983)**
Initial Cash Deficit	(18,946)
Integrated Waste Fund Transfer Reversal	(3,722)
Total Beginning Cash Deficit	**(22,668)**
Total Deficiency	**(63,651)**
Pre-Pendency Plan	9,318
9-Point Plan Adjustment	(296)
Net Pre-Pendency Impact	**9,022**
Total Deficiency with Pre-Pendency	**(54,629)**

Projected Average Deficiency Over 5 Years	***(44,004)***
Required Percentage Impact to Total Annual Expenditures	***26.5%***
OR	
Required Percentage Impact to Salary, Wages & Benefits	***35.6%***

Note: The table above reflects the July 31, 2012 General Fund cash deficit, the FY 2012-13 General Fund preliminary budget ("Baseline") deficit, the impact of the Pre-Pendency Plan as adjusted by the 9-Point Plan, and the projected 5 year average General Fund deficiency.

PENDENCY PLAN ELEMENTS – FY2012-13 and FY2013-14

Item	FY 2013 Impact	Notes
Salary, Wages and Benefits Balancing Measures		
1. Workforce and Service Reductions	$ 13,452,000	Reflects the savings from Pre-Pendency Plan less SAFER grant.
2. Police Vacancies (Voluntary Separations)	3,280,000	Sworn positions included in the proposed FY 2012-13 budget totaled 299. The Pre-Pendency Plan addressed the 18 vacancies that existed at that time, reducing the number of sworn to 281. It is anticipated there will be 268 sworn positions filled as of 12/2012 and 258 filled as of 01/2013. It is recommended the number be set at 260.
3. Police 13.989% Benefit Concession	3,252,000	Reflects 50% of the normal PERS costs; the recent change to state law encourages cities to implement the full cost sharing by 2018.
4. Fire 13.989% Benefit Concession	1,894,000	Reflects 50% of the normal PERS costs; the recent change to state law encourages cities to implement the full cost sharing by 2018.
5. Miscellaneous 9.304% Benefit Concession	651,000	Reflects 50% of the normal PERS costs; the recent change to state law encourages cities to implement the full cost sharing by 2018.
6. Fire Overtime ("OT") Reduction	921,375	Elimination of Constant Manning provisions in MOU; a conservative formula estimated that 35% of the Fire Department OT costs were related to the Constant Manning provision. This number reflects a 35% reduction in Fire OT.
7. OPEB Implied Subsidy Phase Out	0	Reflects the reduction of the implied subsidy to existing retirees of roughly $800,000 to $1 Million annually beginning January 1, 2014.
8. OPEB Direct Subsidy Phase Out	213,750	Reflects the reduction of the direct payment to existing police retirees to the $112 per month afforded to other retirees beginning January 1, 2013. Elimination of the subsidy would result in savings of $427,000 for FY 2012-13.
9. EPMC	2,400,000	The City currently provides through an MOU a 9% salary adjustment for Police and Fire employees to cover the cost of the Employer Paid Member Contribution (EPMC) benefit. The City could eliminate the 9% contribution and require the employees receiving this benefit to pay the contribution through salary deductions. The annual savings to the City is $2.4M.

Item	FY 2013 Impact	Notes
Subtotal Salary, Wages & Benefits	**$ 26,064,125**	
Deferral of General Fund Obligations		
10. Defer Reimbursement to Restricted and Non-Restricted Funds	$ 15,156,944	Reimbursement will be addressed in future years.
11. CalPERS Payments less Employee Withholding (ER)	12,974,727	Reflects the deferral plus the balance of the payments due and payable and not paid. Assumes repayment at some future date to be negotiated with creditor and assumes resumption of payments in FY 2013-14.
12. Paid Time Off Payments	3,453,175	Vacation, sick leave, holiday and concession leave time accruals.
13. Pension Bond Payments	3,374,465	Reflects deferral of principal and interest.
14. Reamortize CalPERS Liability over 30 yrs (Fresh Start)		Discussions with CalPERS actuarial staff are underway; would realize value of $1.3 million per year starting Fiscal Year 2014.
Subtotal Deferrals	**$ 34,959,311**	
Revenue Related Balancing Measures		
1. Real Property Transfer Tax	$ -	Increase to $5 per $1,000 transferred; projected $3 million annually in future years.
2. Transient Occupancy Tax	-	Increase from 10% to 12% projected $800,000 annually in future years.
3. Utility User Tax	-	Increase from 7.75% to 9.5%; projected $5.25 million annually in future years.
4. 911 Communications Fee	-	Projected $6.7 million annually in future years.
Subtotal Revenue	$ -	Projection model assumes about $5.1 million in new revenue in future years (33% of total revenues).
Total Balancing Measures	**$ 61,023,436**	

General Fund Cash Projection		FY 2013 Base Year		2014 Projection
Inflows / Outflows				
Source: Preliminary and Pre-Pendency Projections				
Property Tax	$	27,267,362	$	27,812,709
Sales Tax		28,221,871		29,068,527
Measure Z		5,809,910		5,984,207
Franchise Fees		3,376,300		3,470,153
Transient occupancy tax		2,600,000		2,639,000
Utility users tax		22,500,000		22,459,826
Business registration		6,450,000		6,666,745
Fee & Permits		9,890,300		10,384,815
Fines, Enforcement, Restitution		2,104,300		2,104,300
Use of Money and Property		733,000		366,500
Intergovernmental (Grants, Other Govts)		6,086,300		2,373,657
Miscellaneous		1,501,100		1,062,028
Credits/Grant Offset (Acct# 5910)		3,883,722		1,941,861
Total Annual Inflows		120,424,165		116,334,328
Salaries		75,753,606		75,753,606
Overtime		8,445,590		8,445,590
Retiree Health Payments		6,658,000		6,824,450
PERS Payments		21,203,234		21,501,555
Health Insurance		6,581,520		6,746,058
Other benefit payments		4,866,137		4,866,137
Subtotal Salaries & Benefits		123,508,087		124,137,396
Operations & Maintenance		5,695,842		5,866,717
Contractual Services		6,345,020		6,535,371
Internal Service Fund Charges		21,190,098		21,825,801
Equipment		2,314,380		-
Debt Service		5,183,130		5,187,543
Other/Claims/Liabilities		2,000,000		-
SubTotal O&M, ISF, Eq, D/S		42,728,470		39,415,432
Total Expenditures - Outflows		166,236,557		163,552,828
Net Revenues / Deficit Before Transfers		(45,812,392)		(47,218,499)
Transfers In		7,932,600		9,759,263
Transfers Out		(3,102,958)		(3,481,519)
Net Transfers		4,829,642		6,277,744
Net Cash Excess /(Requirement)	$	(40,982,750)	$	(40,940,755)
Beginning Cash	$	(18,946,180)	$	(29,745,250)
Ending Cash	$	(59,928,930)	$	(70,686,005)

General Fund Growth Assumptions	FY 2013 Base Year	2014 Projection
Inflows / Outflows		
Property Tax		2.0%
Sales Tax		3.0%
Measure Z		3.0%
Franchise Fees		2.8%
Transient occupancy tax		1.5%
Utility users tax		(0.2%)
Business registration		3.4%
Fee & Permits		5.0%
Fines, Enforcement, Restitution		-
Use of Money and Property		(50.0%)
Intergovernmental (Grants, Other Govts)		(61.0%)
Miscellaneous		(29.3%)
Credits/Grant Offset (Acct# 5910)		(50.0%)
Salaries		-
Overtime		-
Retiree Health Payments		2.5%
PERS Payments		1.4%
Health Insurance		2.5%
Other benefit payments		-
Operations & Maintenance		3.0%
Contractual Services		3.0%
Internal Service Fund Charges		3.0%
Equipment		-
Debt Service		-
Other/Claims/Liabilities		(100.0%)
Transfers In		(9.7%)
Transfers Out		12.2%